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CITATIONS

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Miscellaneous—Continued

In the Supreme Court of the United States

October Term, 1955

No. 74

United States of America, petitioner

v.

Leslie Salt Co.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court's opinion (R. 18–20) is reported at 110 F. Supp. 680. Its findings of fact and conclusions of law (R. 29–33) are not reported. The opinion of the Court of Appeals (R. 138–139) is reported at 218 F. 2d 91.

JURISDICTION

The judgment of the Court of Appeals (R. 140) was entered on December 16, 1954. By order of Mr. Justice Douglas, dated March 3, 1955 (R. 140), the time for filing a petition for a writ of certiorari was extended to and including May 14, 1955. The petition for a writ of certiorari was

filed on May 12, 1955, and was granted on June 6, 1955. (R. 141.) The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTION PRESENTED

The taxpayer obtained $4,000,000 from two insurance companies under identical agreements which provided for repayment over a period of fifteen years, and imposed extensive conditions and limitations upon it. The question presented is whether the two "3¼% Sinking Fund Promissory Notes" issued in connection with this transaction are subject to the documentary stamp tax imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939 on "all bonds, debentures, or certificates of indebtedness issued by any corporation * * *."

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 1800. IMPOSITION OF TAX.
>
> There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections.
> (26 U. S. C. 1952 ed. 1800.)

SEC. 1801 [As amended by Section 1 of the Revenue Act of 1939, c. 247, 53 Stat. 862; Section 209 of the Revenue Act of 1940, c. 419, 54 Stat. 516; and Section 521 (a) (3) of the Revenue Act of 1941, c. 412, 55 Stat. 687]. CORPORATE SECURITIES.

On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue * * *.
(26 U. S. C., 1952 ed. 1801.)

Treasury Regulations 71 (1941 ed.):

SEC. 113.50. *Scope of Tax.*—Section 1801 imposes a tax upon the issue by any corporation of bonds, debentures, certificates of indebtedness, and all instruments, however termed, with interest coupons or in registered form and known generally as corporate securities. Every renewal of the above described instruments is taxable as a new issue.

SEC. 113.55. *Issues Subject to Tax.*—Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc.

Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called.

* * * * *

STATEMENT

In 1948, the taxpayer owed approximately \$2,000,000 to certain banks. (R. 46–47.) In order to fund, extend, and increase the amount of the indebtedness, and to obtain needed working capital, it obtained \$4,000,000 from the Pacific Mutual Life Insurance Company and the Mutual Life Insurance Company of New York, Pacific Mutual furnishing \$1,000,000 and Mutual of New York \$3,000,000, pursuant to separate but identical agreements (R. 44–45, 85, 93–133) executed under date of February 1, 1949. To evidence this transaction the taxpayer executed two instruments, also dated February 1, 1949, one of which is printed at page 87–89 of the record.[1]

These instruments, identical except for amount and name of payee (R. 44–45, 85), were denomi-

[1] Under date of February 15, 1949, the closing date under the agreement, the taxpayer also executed a separate "Certificate" pursuant to each agreement (R. 44, 45; 85, 90–93) purporting to certify that there had been no adverse changes in its condition since execution of the agreement.

nated "3¼% Sinking Fund Promissory Note Due February 1, 1964," and stated that the taxpayer promised, for value received, to pay to the payee named therein, on February 1, 1964, the principal amount, and to pay on August 1 and February 1 of each year interest at the rate of 3¼% per annum on the unpaid balance. Each note[2] recited that it was one of several such notes, each of the denomination of $1,000 or a multiple thereof, made or to be made by the taxpayer in an aggregate principal amount of $4,000,000, all maturing 15 years thereafter on February 1, 1964, and bearing interest payable at the same rate and on the same dates. Each note also provided that the holder, at his option, might surrender it for exchange at the office of the taxpayer and without expense receive therefor a note or notes in authorized denominations, dated as of the date to which interest had been paid on the original note.

Each payment in reduction of principal was to be recorded on the note, and it was further specified that (R. 88-89)—

> This Note is issued under and is entitled to the benefits of the provisions of an Agreement of the Company dated February 1, 1949, with respect to the Notes, a copy of such Agreement being on file at the principal office of the Company. As provided

[2] Throughout this brief, the word "note" is used solely for the purpose of convenient reference, and not for the purpose of characterization.

in said agreement the Notes may be prepaid prior to maturity at the option of the Company. As further provided in said agreement, the Notes are entitled to the benefits of the sinking fund provided for therein and are subject to prepayment through the operation of such sinking fund. In case an Event of Default, as defined in said agreement, has occurred, the principal of the Notes may be declared or may become due and payable in the manner, at the time, and with the effect provided in said Agreement.

The two separate but identical agreements, dated February 1, 1949, are lengthy and detailed instruments, one of which is reprinted at pages 93–133 of the record. These agreements were expressly made part of the notes, and made binding on all succeeding holders of the notes. (R. 132.) In summary, by Section 1 of the agreement (R. 93–94) the taxpayer agreed to "sell," and the insurance companies agreed to "purchase" from the taxpayer as of the "closing date," a note in the principal amount at a "purchase price" equal to 100% of the principal amount plus interest from February 1, 1949, to the closing date.

Section 2 (R. 95–96) recorded delivery to the insurance company of taxpayer's balance sheets for 1944–1948 and other materials describing taxpayer's business and properties, and contained representations by the taxpayer as to its past earnings and financial condition.

Section 3 (R. 96–100) enumerates the conditions under which the lenders agreed to "purchase" the notes, the more important of which were (1) that the lenders should receive the opinion of legal counsel that the transaction was exempt under the Securities Act of 1933, c. 38, 48 Stat. 74 (15 U. S. C. 1952 ed., Sec. 77a, *et seq.*); (2) that it was not necessary in connection with such purchase to qualify an indenture under the Trust Indenture Act of 1939, c. 411, 53 Stat. 1149 (15 U. S. C. 1952 ed., Sec. 77aaa, *et seq.*); and (3) that since the purchaser was acquiring the note for investment and not with a view to distribution, if in the future the purchaser should deem it expedient to sell the note or any notes which might be issued in exchange therefor, such sale would be an exempt transaction under the Securities Act of 1933, as amended, and would not of itself require registration of the note or such new notes, although such registration would be required as a condition of any distribution by underwriters, as defined in that Act, if at the time of sale the lender controlled the taxpayer.

Section 4 (R. 100–102) stated that the agreement was made on the representation of the purchaser that it was acquiring the note for its own account, and not with a view to, or for sale in connection with, the distribution thereof. However, recognizing the unqualified right of the purchaser to dispose of its property, the section further provided that so long as the purchaser held

a note or notes of the aggregate principal amount of $300,000 or more, the taxpayer would, upon receipt of a written request, execute and deliver at its own expense a trust indenture providing for the issue thereunder of new $3\frac{1}{4}\%$ sinking fund notes of the taxpayer due February 1, 1964, limited to the principal amount of notes unpaid at the date of execution of the agreement, bearing interest at the rate and entitled to the substantive benefits of the original notes. The taxpayer agreed, upon execution of such a new indenture, to issue new notes of the same or a different authorized denomination or denominations ($1,000 or a multiple thereof) either in registered form without coupons or in coupon form, in printed or in fully engraved form, and bearing interest from the date to which interest had been paid on the surrendered note or notes, the taxpayer to bear all expenses in connection therewith, including "all stamp and other taxes" except transfer taxes.

Section 5 of the agreement (R. 102–105) contained the sinking fund and prepayment provisions. By paragraph 1 of that section the taxpayer was required to make "Fixed Sinking Fund Payments" annually, beginning February 1, 1951, in the amount of $285,000, without premium. Paragraph 2 provided that on each fixed sinking fund payment date the taxpayer, at its option and upon giving prior written notice, "may call for prepayment," without premium, of a further principal amount of the notes equal to $285,000, pro-

vided such payment is made from earnings or proceeds of liquidation of assets, and not from other sources. Paragraph 3 provided for "Optional Prepayments," upon written notice by the taxpayer not less than 30 days or more than 60 days prior to the date of such prepayment, either of the entire unpaid balance of principal or any part thereof not less than $50,000, with interest to the date of prepayment, plus graduated premiums ranging from 3% if prepaid in the twelve-month period ending January 31, 1950, to none if prepaid in the final twelve-month period ending January 31, 1964.

By Section 6 of the agreement (R. 105-110) the taxpayer convenanted, on behalf of it and its subsidiaries, to pay promptly all taxes, assessments, governmental charges, etc., so long as any note or notes were outstanding; to keep their respective properties in good repair, working order and condition, and make all needed and proper renewals, replacements, extensions, betterments and improvements for the advantageous conduct of their business; to keep full and accurate business records; to reflect in their financial statements proper reserves for depreciation, depletion, obsolescence, accruals for federal and all other taxes, and all other appropriations to reserves which should be made in accordance with sound accounting practices; to keep all of their plants, properties, and inventories of an insurable character adequately insured. And in paragraph 6 the taxpayer agreed

to supply future financial statements to each holder of 10% or more in principal amount of the notes, such statements to be certified by an independent public accountant selected by the taxpayer and approved by each holder of 20% or more in principal amount of the notes.

By Section 7 of the agreement (R. 110-121), the taxpayer agreed that neither it nor any of its subsidiaries would create, incur, or assume any additional indebtedness, except "Unsecured Current Liabilities" or "loans from commercial banks incurred in the ordinary course of * * * business." It also promised that it would not mortgage, encumber, or dispose of any of their properties without adequate consideration, or make any long-term leases which do not satisfy certain specified conditions; would not declare dividends or make distributions, with certain exceptions which would not affect the security of the loan; would maintain a net working capital at all times of at least $1,000,000; would not assume any secondary liability by guarantee or otherwise; would limit investments, loans, and advances to the extent specified; and would not sell, transfer or otherwise dispose of any substantial part of its assets, nor merge or consolidate with any person, except under specified conditions.

Section 8 (R. 121-126) defined certain terms used in the loan agreement; Section 9 (R. 126-128) enumerated the events which would constitute a default on the part of the taxpayer and

make the entire unpaid balance of the loan immediately due and payable; and Section 10 (R. 128-133) contained certain miscellaneous clauses, such as a provision giving the holder of any note the right to inspect the taxpayer's premises as well as its books of account; and a provision obligating the present holder of the note to mark on it any interest and principal paid prior to selling such note.

The Commissioner of Internal Revenue assessed a documentary stamp tax against the taxpayer in the amount of $4,400 pursuant to Sections 1800 and 1801 of the Internal Revenue Code of 1939 with respect to its issuance of the above-described notes. The tax was paid under protest and the taxpayer filed a timely refund claim. (R. 41-42.) This claim was rejected by the Commissioner (R. 134-137), but the district court held the instruments were not subject to the documentary stamp tax (R. 18-20, 29-33) and the court of appeals affirmed (R. 138-139, 140).

SUMMARY OF ARGUMENT

The Internal Revenue Code of 1939 imposes a stamp tax of eleven cents a hundred dollars on "bonds, debentures, or certificates of indebtedness." The taxpayer sold to two insurance companies two instruments denominated "Sinking Fund Promissory Notes" which totalled $4,000,000, had a 15-year maturity and were subject to elaborate covering agreements imposing detailed

restrictions on the taxpayer for the benefit of the investors. The issue is whether these instruments are "debentures" or "certificates of indebtedness" under the Code.

I

Since the name attached to the documents by the taxpayer cannot be determinative of their taxability, it is necessary to consider their fundamental characteristics. Both lexicographers and judges have given the word "debenture" a broad meaning, generally including all corporate indebtedness. Specifically, it has been used to distinguish unsecured obligations from bonds, and long-term instruments coupled with elaborate protective covenants from ordinary promissory notes. The instruments here in question are included within such definitions. They have terms of 15 years and the accompanying agreements provide detailed limitations on the taxpayer's activities in order to protect the insurance companies' investment.

The fact that the instruments were sold in large blocks to two insurance companies rather than distributed in smaller fractions to public investors does not alter the nature of the obligations themselves. The financing was accomplished by what is known as a "private placement," a method of obtaining capital which has become popular since the passage of the Securities Act of 1933 because of the economies and convenience

so obtained. It is today widely used. But its novelty is in the method of sale followed, not in the nature of the obligation sold. If a large number of conventional debentures were sold to the same insurance companies totalling the same amount, there would be no doubt about the applicability of the stamp tax. Yet here the buyers have the right to demand that their notes be broken up into smaller instruments and supplemented by a conventional trust indenture. Since the features of the original notes are fundamentally the same as those of the fragments which would result, it is clear that the original notes are just as truly debentures as their subdivided counterparts.

Concededly, the detailed restrictions accompanying the notes here involved were embodied in an "agreement" rather than an "indenture," the notes were printed on plain white paper rather than being engraved on tinted paper, and the trustee who normally acts as intermediary between the security holders and the issuer was eliminated. But these insignificant variations are traceable to the fact that the instruments were drafted for private placement. The differences are not fundamental and do not alter the essential character of the securities.

II

These securities are taxable not only because they are "debentures", but also because they are

covered by the phrase "certificates of indebtedness." Congress apparently used this additional comprehensive description as a catchall to apply the tax to all types of long-term corporate debt. The term, as used, is not a term of art having a technical or restricted meaning but a descriptive phrase of general application.

III

In addition to the tax on debentures and certificates of indebtedness, the Code, prior to 1924, imposed a separate tax, at a lower rate, on "promissory notes." This tax was repealed in 1924. The taxpayer advanced the argument below that the "Sinking Fund Promissory Notes" here involved are therefore exempt from tax.

However, analysis shows that the tax on "promissory notes" was intended to apply to ordinary commercial paper, not to long-term formal obligations tied in with elaborate protective covenants such as are here involved. This appears in part from the linking of the term "promissory notes" with "drafts" and "checks," and in part from the legislative history which contains several references to ordinary short-term promissory notes. Moreover, since private placements were not in extensive use at the time Congress acted on "promissory notes," the financial community at that time was not accustomed to referring to such long-term formal obligations as

"promissory notes," and therefore Congress could not have had in mind the instant type of instrument when it repealed the tax on "promissory notes."

IV

Although the courts have achieved divergent results in passing upon the taxability of long-term institutional loans, the elements which have led some courts to find them not covered are absent here. For example, in *Niles-Bement-Pond Co.* v. *Fitzpatrick,* 213 F. 2d 305 (C. A. 2), the court placed emphasis on the fact that the instruments were not marketable, as evidenced by the absence of a provision that they could be broken up into smaller pieces. In the present case, however, there is a specific provision requiring the taxpayer on request from the insurance companies to substitute instruments of smaller denominations, in registered form or with coupons attached, and supported by a standard trust indenture. In *Niles,* words such as "purchase," "sale," and "investment" were absent; here such language is used. In *Niles,* the money came from banks; here it came from insurance companies. It is therefore entirely possible to reconcile the decision we seek with the decision in *Niles* and all other Court of Appeals cases holding against taxability. However, we think that the distinctions drawn in those cases are unsound, and we rely chiefly on the

argument presented above that these instruments are taxable because they represent long-term indebtedness incorporated in a formal agreement and tied in with elaborate protective covenants. Such instruments, we believe, Congress intended to tax when it enacted Sections 1800 and 1801 of the Code.

ARGUMENT

TAXPAYER'S "NOTES", WHICH REPRESENT LONG-TERM UNSECURED CORPORATE DEBT IN A VERY SUBSTANTIAL AMOUNT INCURRED FOR CAPITAL PURPOSES AND SUPPORTED BY AN ELABORATE PROTECTIVE AGREEMENT, ARE "DEBENTURES" AND "CERTIFICATES OF INDEBTEDNESS" WITHIN THE MEANING OF SECTIONS 1800 AND 1801 OF THE INTERNAL REVENUE CODE

The sole issue in this case is whether the two "3¼% Sinking Fund Promissory Notes" issued by the taxpayer to evidence the $4,000,000 transaction with the Pacific Mutual Insurance Company and the Mutual Life Insurance Company of New York are subject to the stamp tax under Section 1801 of the Internal Revenue Code of 1939, *supra*, p. 3, which provides that a tax shall be levied—

> On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons

> or in registered form, known generally as corporate securities * * *.

Since the instruments here involved were not in registered form and did not have coupons attached (R. 31), and since they were concededly not bonds, the only question which remains[3] is whether they were "debentures" or "certificates of indebtedness."

Before considering in detail the meaning of the words "debenture" and "certificate of indebtedness" perhaps it should be emphasized at the outset that the formal designation given to the instruments by the taxpayer obviously cannot be determinative for tax purposes. See, e. g., *Belden Mfg. Co.* v. *Jarecki*, 192 F. 2d 211, 212 (C. A. 7th); *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593 (C. A. 2d), certiorari denied,

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[3] Initially there was some authority to the effect that the registration or coupon requirement in the second part of Section 1801 applied to all instruments under the section (see *Bellefield Co.* v. *Heiner*, 25 F. 2d 560 (C. A. 3d)), or that the tail phrase "known generally as corporate securities" qualified everything that went before (*Wilkinson* v. *Mutual Bldg. & Sav. Ass'n*, 13 F. 2d 997 (C. A. 7th)). But these interpretations have not been adopted in any subsequent cases. On the contrary, they have been specifically rejected. *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, 596–597 (C. A. 2d), certiorari denied, 332 U. S. 810; *Commercial Credit Co.* v. *Hofferbert*, 93 F. Supp. 562, 565–566 (D. Md.), affirmed *per curiam*, 188 F. 2d 574 (C. A. 4th); *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243 (C. Cls.), certiorari denied, 346 U. S. 864. See also Treasury Regulations 71, §§ 113.50 and 113.55, *supra*, pp. 3–4.

332 U. S. 810. As stated in the Regulations (Section 113.55, *supra*, pp. 3–4):

> the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such.

By this it is not meant to suggest that the Court should decide on the basis of instruments which might have been issued, rather than on the basis of those which were used. This Court made clear in *United States* v. *Isham*, 17 Wall. 496, that stamp taxes are imposed on the documents actually used even though other documents, which would have achieved the same economic result, might entail different tax consequences. The inquiry, therefore, must turn on a comparison of the essential characteristics of the "notes" here involved with the fundamental features of "debentures" and "certificates of indebtedness" as those terms are used in the Internal Revenue Code.

A. THE WORD "DEBENTURE" AS GENERALLY DEFINED AND AS INTERPRETED BY THE COURTS INCLUDES THE "NOTES" HERE INVOLVED.

The term "debenture" has generally been given a broad meaning.[1] In England, where the term

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[1] The term is not defined anywhere in the statute or Regulations.

originated, it has been said (*Edmonds v. Blaina Furnaces Co.*, 36 Ch. Div. 215, 219, 221 (1887)):

> The term itself imports a debt—an acknowledgment of a debt—and speaking of the numerous and various forms of instruments which have been called debentures without anyone being able to say the term is incorrectly used, I find that generally, if not always, the instrument imports an obligation or covenant to pay. This obligation or covenant is in most cases at the present day accompanied by some charge or security. So that there are debentures which are secured, and debentures which are not secured.[5]
>
> * * * * *
>
> I have seen debentures of various kinds and classes, and it is a mistake to say that to be debentures the instruments must be issued and numbered *seriatim*. I have even seen a single debenture issued to one man. * * *[6]

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[5] In England, the term "debenture" refers to both secured and unsecured obligations, whereas in the United States it is generally used to refer to unsecured obligations only. See Badger and Guthmann, *Investment Principles and Practice* 156, fn. 9 (3d ed., 1941).

[6] See also *Levy* v. *Abercorris Slate and Slab Co.*, 37 Ch. Div. 260 (1887), to the same effect. In that case an instrument evidencing a £600 loan was held to be a debenture. And see *British India Steam Navigation Co.* v. *Commissioners of Inland Revenue*, 7 Q. B. D. 165 (1881), where the court was faced with a problem similar to that presented by the instant case—to decide whether an instrument was a debenture or a promissory note for stamp tax purposes.

And in Simonson on *Debentures and Debenture Stock* 5 (3d ed., 1902), a leading English treatise on the subject, the following definition is given:

> any instrument (other than a covering or trust deed) which either creates or agrees to create a debt in favour of one person or corporation, or several persons or corporations, or acknowledges such debt, is a debenture.[7]

In the United States, also, the term covers considerable ground.[8] Thus, in Webster's New International Dictionary (2d ed., 1949), a number of different meanings including the following are given:

> Any of various instruments issued by corporations as evidences of debt. Such instruments (often called *debenture bonds*) are generally, though not necessarily, under seal, and are usually secured by a mortgage or other charge upon property; they may be registered or unregistered. * * * In some cases the debenture is no more than an unsecured promissory note of the corporation bearing a fixed rate of interest.

The definitions found in financial texts, moreover, are equally broad and flexible. Thus, in Munn, *Encyclopedia of Banking and Finance*

[7] See also Topham, *Palmer's Company Law* 272 (19th ed., 1949); Wegenast, *Canadian Companies* 630 (1931).

[8] 2 Jones, *Bonds and Bond Securities* 9 (4th ed., 1935); Husband and Dockeray, *Modern Corporation Finance* 101 (3d ed., 1952).

167 (5th ed., 1949), the term "debenture" is defined as:

> A class term for all forms of unsecured, long term debt, whether for corporate or civil (Government, state or municipal) obligations, although it is usually applied to a certificate of debt issued by a corporation.

And in Graham and Dodd, *Security Analysis* 83, fn. 1 (2 ed., 1940), it is stated: "The term 'debenture' in American financial practice has the accepted meaning of 'unsecured bond or note.'" Again in the *Practical Handbook of Business and Finance* 169 (Rev. ed., 1936), the term is defined as follows:

> A certificate of debt issued by a corporation. Unless secured by a mortgage, it is simply a promise to pay, or in other words, a promissory note.[9]

Courts have similarly defined the term. Judge Aldrich in *S. S. Pierce Co.* v. *United States*, 127 F. Supp. 396 (D. Mass.), appeal pending, stated at page 399:

> It is to be borne in mind that a debenture is, after all, nothing but a glorified promissory note.

And Judge Chase in *General Motors Acceptance Corporation* v. *Higgins*, 161 F. 2d 593, 596 (C. A.

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[9] For further definitions, see *e. g.*, Mead, *Corporation Finance* 281 (5th ed., 1925); American Institute of Accountants, *Accounting Terminology* 45 (1931); 1 Dewing, *Financial Policy of Corporations* 226 (5th ed., 1953).

2), quotes with approval the general definitions of a number of financial writers including Lough, *Corporation Finance*, Vol. VI (1914) which states:

> In law any instrument which formally acknowledges a debt and promises payment, including any written bond secured or unsecured, is a debenture. In finance, however, the term has come to be restricted to a bond which is not secured by a lien upon any specific property. In other words, it is, for all practical purposes, simply an unsecured promissory note running for a number of years.

It is thus evident that the term "debenture" has no restricted legal meaning, but rather is a generic term for various types of corporate indebtedness.

However, when the word "debenture" is used to distinguish particular types of corporate debt obligations from others, it is applied to unsecured debt, in contrast to "bonds", and to relatively long-term formal notes, in contrast to short-term promissory notes considered as current liabilities. In 1 Dewing, *Financial Policy of Corporations* (5th ed., 1953), it is stated at pages 226, 229–230:

> There is a large class of straight credit obligations unsecured by any direct pledge of specific property. They are called debentures. Such obligations are merely promises to pay a certain sum of money at a given time. Prior to 1899, most deben-

ture bonds recited on their face the conditions, if any, under which they were issued and the specific covenants, if any, made by the corporation. This often necessitated lengthy bonds. More recently, however, most debentures have been issued under an agreement or indenture, in which a trust company—often called the trustee—is mentioned as an agency to supervise the execution of the covenants of the agreement.

* * * * *

Sometimes it is provided that no further debentures shall be issued. Most common, however, is the provision that no mortgages may be created on the property without including the issue of debentures within the security of the new mortgage. After the lessons of the abrupt reversal of business of 1920–21 had been borne home, a new protection in the form of restrictions on open market borrowings was inserted in many debenture bond contracts.

Two protective covenants are especially important in protecting the investor in the debenture bonds of all types of corporations, especially corporations engaged in industries having large inventories. Some restraining clause must be included in the debenture agreement which protects the holders against the unrestricted future issue of debentures having a parallel position. Of even greater importance, especially in the protective covenants of industrial debentures, are restrictions to

> prevent the uncontrolled increase in current liabilities. The restrictions must, however, be reasonable so as not to interfere with the regular course of the business. Usually the covenant requires that the corporation shall maintain a liberal margin of quick assets in excess of current liabilities including the early maturities of the debentures.[10]

Judge Chesnut recognized this use of the word in *Commercial Credit Co.* v. *Hofferbert*, 93 F. Supp. 562 (D. Md.), affirmed, 188 F. 2d 574 (C. A. 4), when he stated at page 565:

> In modern current use in financial circles the term is generally understood to represent an instrument denoting a corporate obligation issued for long term capital financing and described in a covering agreement or indenture, not creating a mortgage or lien on real or personal property, but nevertheless ordinarily containing certain agreements, covenants or restraints which, if not observed, would tend to prejudice the ability of the issuer to meet its obligations.

When the two 15-year "3¼% Sinking Fund Promissory Notes" here involved are viewed in light of the foregoing descriptions it is apparent that they have all the essential characteristics of conventional debentures. Thus, the instruments here in issue were accompanied by detailed agreements prohibiting, *inter alia*, the assumption of

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[10] See also the article "Floating Debenture" in 6 Encyclopedia Britannica 147 (1948).

any additional indebtedness, save that required in the normal course of business (R. 110–111), and the creation of any "mortgage, pledge, encumbrance, lien or charge of any kind upon any of its property or assets" (R. 112). The present instruments go even further in that they restrict the payment of dividends (R. 115–116), and the making of loans and investments (R. 117–118), prohibit any merger or consolidation (R. 119–120) and require the company to maintain at all times a working capital of at least $1,000,000 (R. 116).

It is thus apparent that the instruments here involved not only fit within the generic definition of the term "debenture," *supra*, pp. 18–22, but also contain all the typical provisions characteristic of standard corporate debentures.[11]

The complicating factor in the present case is not the nature of the obligations, but the way in which they were issued, being sold to two insurance companies in large blocks rather than distributed to

[11] Compare the characterization of instruments similar to the present ones in *S. S. Pierce Co. v. United States*, 127 F. Supp. 396, 399, fn. 7 (D. Mass.):

> Indeed, if one disregards such seeming inconsequentials as the color of the paper and the substitution of typewriting for printing, there is considerable similarity between the documents at bar and the more usual corporate debenture. Each consists of a single summary page, containing the promise to pay and incorporating by reference a more detailed set of agreements and conditions. In the one case the incorporated document is usually termed an indenture; in the case at bar it is termed a loan agreement.

the public through an underwriter. This method of sale, generally referred to as "private placement", is an increasingly prevalent practice in corporate finance and consists of the placing of large-scale long-term debt directly with institutional investors (such as banks, insurance companies and pension trusts), rather than obtaining needed capital through the public flotation of securities.[12] The transaction may be accomplished through the issuance of so-called promissory notes accompanied by elaborate agreements, as in the instant case, or it may take the form of simply placing an entire issue of securities directly with one or more institutional investors.

The principal advantages of this method of capital financing are said to be that the corporation desirous of obtaining further capital is saved the expense incident to a public issue, that it does not have to subject itself to the fluctuations of the public securities market during the protracted period prior to the effective date of the registration statement under the Securities Act of 1933, and finally, that the direct dealing between issuer and investor makes possible an agreement tailored to the special circumstances of each par-

[12] See, *e. g.*, Corey, *Direct Placement of Corporate Securities* (1951); 2 Dewing, *Financial Policy of Corporations* 1167–1122 (5th ed., 1953), and authorities there cited in footnote 5. See also 2 House Hearings Before Subcommittee of the Committee on Interstate and Foreign Commerce, 82d Cong., 2d Sess. (Part 2), *Direct Placements of Corporate Securities*.

ticular case.[13] Statistical studies of the growth of this phenomenon indicate that, while direct placements were completely insignificant quantitatively in the first quarter of the twentieth century, they have risen to a very sizeable proportion of all security offerings in recent years. In 1951, for example, 58.4% of all corporate debt issues and 44.1% of all corporate offerings were privately placed. Moreover, if railroads and public utilities which are customarily required to offer their securities by means of competitive bidding are eliminated, we find that during the period from 1948 to 1951 82.3% of all debt issues offered by manufacturing corporations were privately placed.[14]

Thus, the private placement simply constitutes another method for accomplishing precisely the same objective as the public issuance of securities[15]—to obtain capital on a long-term basis—

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[13] Corey, fn. 12, *supra*, p. 142; Dewing, fn. 12, *supra*, pp. 1112-1117.

[14] Securities and Exchange Commission, *Privately Placed Securities—Cost of Flotation* 2-6 (1952).

[15] Some of the cases which have arisen under the stamp tax indicate the complete interchangeability of the two forms of financing. Thus, in *Knudsen Creamery Co. of California* v. *United States*, 121 F. Supp. 860 (S. D. Calif.) four so-called long-term notes were issued, two to a bank and two to an insurance company, in order to refinance the company's publicly issued 4½% first mortgage serial bonds and its 5½% sinking fund debentures. Similarly, in *United Air Lines* v. *United States* (N. D. Ill.), decided February 9, 1955 (1955 P-H, par. 72,567), appeal pending, the company originally intended to issue $10,000,000 of preferred stock, $25,000,000

except that it eliminates some of the formalities necessary in a public issuance, such as S. E. C. registration [16] and the use of a supervising trustee. The fact that the securities here were sold in two large units rather than many smaller ones has no significance. If the taxpayer had printed a regular set of conventional bonds or debentures and had sold the entire issue directly to the two insurance companies, there would have been no question that the stamp tax would have been applicable.[17]

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of debentures and also to obtain some short-term bank loans. However, when it was informed by its investment bankers that no more than $12,000,000 of publicly issued debentures could be floated, it obtained the rest of the funds through five-year loans from a number of banks, evidenced by so-called promissory notes accompanied by the same types of elaborate restrictions found in the instant case.

[16] It is interesting to note for present purposes that the reason why these private placements are exempt from S. E. C. registration is not that the underlying instruments are not considered "securities" but rather because of the specific "private offering" exemption in Section 4 (1) of the Securities Act of 1933, c. 38, 48 Stat. 74. See Loss, *Securities Regulation* 400-403 (1951). Of course, there is no such "private offering" exemption in the stamp tax.

[17] Professor Corey of the Harvard Business School, in his definitive study of private placements (fn. 12, *supra*), states at page 63:

> A considerable saving frequently realized in the past through direct placement was the avoidance of a United States documentary stamp tax if the security was issued in the form of notes. The ruling of the Bureau of Internal Revenue which made this possible, however, was reversed in 1947 by a court decision. [Citing *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593 (C. A. 2).]

The form of the security (notes) rather than the

Yet, in the present case the lenders have the right to have the notes broken down into small units and supplemented by a standard trust indenture (R. 100–102). The important features of the original "notes" and their fragmented "debentures" would be identical. (R. 102.)[18]

In spite of the general recognition that private placements constitute merely a change in the method of sale rather than a change in the nature of the securities offered for sale, the taxpayer's argument below was in part that these notes cannot be debentures under Section 1801 because they were not "designed for public offering" (Br. 3).[19] But there is nothing in the statute requiring a debenture to be publicly issued in order to be taxable. On the contrary, as the Court of Claims said in *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243, 248:

> The tax imposed by Congress by the enactment of sections 1800 and 1801 was

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method of financing relieved the issuer of the necessity of paying the tax. Thus if the security was a [conventional type of] debenture, a mortgage bond, or an equity, the tax was applicable regardless of whether the issue was placed directly.

[18] Actually, of course, the insurance companies repeatedly stated that they were purchasing these notes for investment and not for resale. (R. 94, 98, 100.)

[19] From this fallacious premise the taxpayer naturally arrives at the conclusion that a debenture must have an indenture and a trustee, must be sold through an investment banker, must be registered with the Securities and Exchange Commission, etc.

> intended to apply to an infinite number and variety of transactions whereby a corporation, through the issuance of certificates and securities, obtained the necessary funds with which to carry out its corporate functions.

And, as pointed out, *supra*, pp. 28–29, the term debenture is not necessarily restricted to one of a large series, and there can be just one debenture issued to one person.[20] There is thus no valid reason why the form of the transaction should lead to such significantly different tax consequences. Cf. *Griffiths* v. *Commissioner*, 308 U. S. 355, 357–358; *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, 255. See also *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60, 63: "The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements."

The court below based its decision largely on the fact that (R. 139):

> There is no satisfactory evidence that Congress intended to tax instruments of this character—certainly none that it did so in anything approaching clear language. It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have

[20] For a case outside of the stamp tax field dealing with such a debenture, see *Keeley* v. *Associated Gas & Electric Co.*, 155 Misc. 146.

> repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development.

But this view, it is respectfully submitted, assumes that simply because a new kind of financing was here utilized, the instruments involved were novel too. On the contrary, as we have shown above, only certain unimportant variations in the form of the instruments and in the details of their protective provisions result from the fact that the securities were the subject of a private placement rather than a public offering. Thus two insurance companies dealing directly with the issuer do not need the protection of engraved certificates on special paper in order to prevent forgery. And since there are, at least originally, only two obligees, the interposition of a trustee to represent them can be dispensed with. Finally, since in their original form the notes are too large for ready negotiation, and are not intended for resale, the notes need not be made negotiable nor be registered. But these are not fundamentals, and variations in them do not change the essential character of the instruments.

In the end, therefore, we return to the proposition that despite the nomenclature applied to these instruments, despite the method by which they were sold, and despite minor variations from traditional publicly distributed securities, they

are formal, long-term, unsecured corporate obligations incurred for capital purposes and supported by elaborate protective covenants, so that, whatever else the word "debentures" may encompass, it certainly covers these instruments.

B. IN ADDITION TO BEING TAXABLE AS "DEBENTURES", THE INSTRUMENTS HERE INVOLVED ARE COVERED BY THE COMPREHENSIVE PHRASE "CERTIFICATES OF INDEBTEDNESS."

Apparently aware of the changing terminology of the securities markets, Congress applied the stamp tax not only to "bonds" and "debentures" but also to "certificates of indebtedness issued by any corporation." Internal Revenue Code, Section 1801, *supra*, p. 3. There is no evidence that Congress intended to use "certificates of indebtedness" as a term of art to describe any specific or particular type of corporate indebtedness. It appears rather to have been used as a nontechnical comprehensive description that would cover all instruments evidencing debt obligations which might somehow not be embraced within the other terms. A similar device was used by Congress in the Securities Act of 1933, 15 U. S. C. 77b (1), where it listed "bond, debenture, evidence of indebtedness." See Loss, *Securities Regulation* 318 (1951).

The term "certificate of indebtedness" is not a common one in corporate finance. It has various limited and very narrow uses in describing particular types of instruments to which Congress obviously could not have intended the statute to

be restricted. Thus, it sometimes refers to a certificate issued by the United States Treasury for current cash requirements and used by the purchaser to meet subsequent tax payments. 31 U. S. C. 754; 26 U. S. C. 3657. Again, trustee's or receiver's certificates have at times been referred to as certificates of indebtedness. See, *e. g.*, *Matter of Follansbee Brothers Co.*, 42 F. Supp. 448 (W. D. Pa.); *United States* v. *Powell*, 95 F. 2d 752 (C. A. 4), certiorari denied, 305 U. S. 619. And some state cases use the term to describe municipal obligations issued for emergency purposes. See, *e. g.*, *State ex rel. Stauss* v. *Cuyahoga County*, 130 Ohio St. 64. On its face the statute precludes any inference that there was a Congressional intent to limit the use of the term to these highly specialized instruments; and of course there is nothing in the legislative history to support so restricted a construction.

Moreover, there is authority for the use of "certificate of indebtedness" as a general description broadly embracing all instruments evidencing debt. In Kohler, *A Dictionary for Accountants* (1952), it is defined at page 79:

> A general term applied to a bond or other security evidencing debts owed, as distinct from a certificate of stock which represents a share in the equity.

The definition in Black's *Law Dictionary* (3d ed. 1933) at page 300 is:

> A form of obligation sometimes issued by public or private corporations having practically the same force and effect as a bond, though not usually secured on any specific property.

So also in the *Practical Handbook of Business and Finance* (Rev. ed., 1936) the phrase is defined at page 103 as "An acknowledgment of debt."

While none of the cases specifically passing on the taxability of instruments used in private placements holds directly that they are "certificates of indebtedness," at least two courts have stated that they are either debentures or certificates of indebtedness, and that it is not necessary to decide which. *Stuyvesant Town Corporation* v. *United States*, 111 F. Supp. 243, 248 (C. Cls.), certiorari denied, 346 U. S. 864; *Kobacker & Sons Co.* v. *United States*, 124 F. Supp. 211 (N. D. Ohio).[21]

The fact that Congress used this additional description of the securities it intended to tax does not, in our opinion, detract from our argument that these particular instruments are taxable as "debentures"; rather, it is suggested that Congress reinforced its primary listing of securities covered by the tax with a more general, all-embracing reference to "certificates of indebtedness.

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[21] The only case holding that such documents are not certificates of indebtedness is *General Motors Acceptance Corporation* v. *Higgins*, 161 F. 2d 593, 595 (C. A. 2), which, without discussion, relied upon a Treasury Regulation now repealed.

C. THE FACT THAT CONGRESS DEALT SEPARATELY WITH "PROMISSORY NOTES" DOES NOT DETRACT FROM THE CONCLUSION THAT THE INSTRUMENTS HERE INVOLVED ARE "DEBENTURES" OR "CERTIFICATES OF INDEBTEDNESS."

Historically, the first federal stamp tax was enacted in 1797, but was repealed again a few years later.[22] And while a stamp tax was reenacted several times subsequently for temporary periods as a wartime revenue measure,[23] it was not until 1914 that the stamp tax became a permanent institution. At that time a tax was imposed in one paragraph and at one specified rate on all "Bonds, debentures, or certificates of indebtedness," and in another paragraph at a lower rate on all "Promissory notes, except bank notes issued for circulation, * * *."[24] Following some other amendments during the years 1914–1924 in the course of which promissory notes were classed with drafts and checks,[25] the tax on these three banking instruments was repealed by Section 1100 (a) of the Revenue Act of 1924, c. 234, 43 Stat.

[22] Act of July 6, 1797, c. XI, 1 Stat. 527, Section 1; repealed, Act of April 6, 1802, c. XIX, 2 Stat. 148, Section 1.

[23] See, *e. g.*, Act of June 13, 1898, c. 448, 30 Stat. 448, Section 6; repealed, Act of March 2, 1901, c. 806, 31 Stat. 938, Section 5, Act of April 12, 1902, c. 500, 32 Stat. 96, Section 7.

[24] Act of October 22, 1914, c. 331, 38 Stat. 745, Section 5 and Schedule A.

[25] In the Act of October 3, 1917, c. 63, 40 Stat. 300, Section 807, the tax was imposed in one paragraph (p. 321) on all "Bonds, debentures, or certificates of indebtedness" and in another (p. 323) on

> Drafts or checks payable otherwise than at sight or on demand, promissory notes, except bank notes issued for circulation, and for each renewal of the same. * * *.

253, 352, and was not later reenacted. The tax on bonds, debentures or certificates of indebtedness, meanwhile, has remained in effect since 1914, and at the time of the transactions here involved was found in Section 1801 of the Internal Revenue Code of 1939.[26]

From the fact that the stamp tax on "promissory notes" was thus repealed in 1924, the taxpayer has sought to draw the inference that the "3¼% Sinking Fund Promissory Notes" here in issue are therefore exempt from tax. This argument is unsound for a number of reasons.

To begin with, as pointed out *supra*, pp. 17–18, the mere fact that the taxpayer chose to designate the instruments here involved "Promissory Notes" does not, of course, bring them within the separate provision governing commercial banking instruments or remove them from the category of "debentures" or "certificates of indebtedness." If a corporation had designated some of its secured bonds as "notes", as indeed is often done,[27] it cannot be assumed that they would have gained the advantage of the lower tax in 1914 or exemption from all tax in 1924. Congress was taxing instruments on the basis of their char-

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[26] The tax is carried forward in Sections 4311 and 4381 of the Internal Revenue Code of 1954. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A325; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 482–483.

[27] See Badger and Guthmann, *Investment Principles and Practice* 132, fn. 11 (3d ed., 1941).

acteristics, not their names." And the instruments here in question are not the kind of "promissory notes" covered by the separate provision, but would have been then, as they are now, taxable because of their essential nature as debentures or certificates of indebtedness.

The legislative history of the various Acts is helpful although not in itself determinative. There is definite emphasis in the debate of both houses[28] on the fact that Congress, in repealing

[28] See, for example, the following statements:

Congressman Hudspeth of Texas (65 Cong. Record, Part 4, 3277):

> Does the gentleman believe that the old farmer who goes to the bank and renews his note every 90 days, as all of we farmers have to do, should pay a tax of 2 cents every time he borrows $100 * * *?

See also 65 Cong. Record, Part 4, 3279.

Congressman Burtness of North Dakota (65 Cong. Record, Part 4, 3277):

> Usually the paper cannot be extended for more than 90 days at a time, and stamps must be attached to every renewal note.

Congressman McKeown of Oklahoma (65 Cong. Record, Part 4, 3279):

> If you are going to reduce taxes, why not give the fellow who is unfortunate a chance in life? He is the man who has to pay this tax.

Senator Broussard of Louisiana (65 Cong. Record, Part 8, 8199–8200):

> The theory and the only justification that the Congress has for imposing a tax of this kind is that it shall be imposed upon anyone who has made money. The individual who makes money is taxed in this bill; so is the corporation and the partnership; but when we come to

the stamp tax on promissory notes, was motivated principally by a desire to aid the ordinary individual having a few small-denomination, 60- or 90-day notes outstanding.[29] And while it is true, as Judge (now Mr. Justice) Harlan pointed out in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F. 2d 305 (C. A. 2), that there was also a reference to larger corporate loans and to a loan extending for a period as long as five years,[30] the fact remains that the promissory notes on which the tax was repealed were always grouped along with such short-term instruments as drafts and checks, whereas instruments designed for long-term capi-

> impose a tax upon an individual who makes a loan from a bank, I think we are absolutely overstepping all boundaries in time of peace.
>
> * * * and it is the people who borrow, the people who have no cash, upon whom this tax is imposed.

Senator McKellar of Tennessee (65 Cong. Record, Part 8, 8200):

> I think it is a nuisance tax, pure and simple. It brings in very little money, comparatively speaking, * * *. * * * and there is no reason for imposing this kind of a tax, which is exceedingly * * * irritating to the public and falls on a class of people that are not able to bear it.

[29] See also statement of L. F. Gates, House Hearings Before Committee on Ways and Means, 68th Cong., 1st Sess., *Revenue Revision, 1924*, p. 233; statement of Congressman Burtness, *id.*, p. 218; and statement of A. H. Emery, House Hearings Before Committee on Ways and Means, 65th Cong., 2d Sess., *Revenue Act of 1918*, pp. 1555–1556. Messrs. Gates and Emery both characterized the tax on promissory notes as a "nuisance" tax, and requested its repeal on that ground.

[30] 65 Cong. Record, Part 4, 3279, 3280.

tal financing (such as bonds and debentures) have always been subjected to the tax.

As explained above, the "3¼% Sinking Fund Promissory Notes" here in issue were specifically designed for private placement. This is a new method of distributing securities virtually unknown in 1914 or 1924 when Congress used the term "promissory notes" in contrast to the phrase "bonds, debentures, or certificates of indebtedness." There was then no Securities Act of 1933 and the other factors which have since given impetus to the private placement had not yet cut into the investment bankers' monopoly on securities distributions. Thus the financial community was not at that time accustomed to referring to securities involved in long-term capital financing as anything other than bonds or debentures. And Congress in using the term "promissory note" undoubtedly referred to the ordinary garden-variety I. O. U. and not to an instrument having such characteristically long-term debt features as restrictions on borrowing and dividends, and a sinking fund.[31]

It is therefore our contention that these so-called "promissory notes" are not the kind of

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[31] Further evidence of the fact that the present instrument is not an ordinary commercial promissory note can be found in the provision of the agreement prohibiting the incurring of further indebtedness similar to that here involved, but making a specific exemption for "loans from commercial banks incurred in the ordinary course of * * * business". (R. 110–111.)

ordinary commercial banking instruments on which the tax was repealed in 1924, but contain all the essential elements of long-term corporate securities, taxable in 1914, 1924 and today. The Congressional intent was to tax them for what they really are.

D. THE FACTORS RELIED ON IN SOME OF THE CASES TO SUPPORT THE CONCLUSION THAT THE INSTRUMENTS THERE INVOLVED WERE NOT TAXABLE ARE ABSENT FROM THE PRESENT CASE.

It would follow from the foregoing discussion that all instruments, no matter what denominated, evidencing large-scale, long-term loans, and accompanied by detailed agreements subjecting the borrower to extensive restrictions, are taxable under Section 1801 of the Internal Revenue Code of 1939.[32] The many courts which have considered this problem, however, have not arrived at such a unanimous conclusion.[33]

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[32] See Note, 54 Col. L. Rev. 428–431.

[33] Decisions holding the instruments involved subject to the documentary stamp tax are: *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593 (C. A. 2), certiorari denied, 332 U. S. 810; *Commercial Credit Co.* v. *Hofferbert*, 93 F. Supp. 562 (D. Md.), affirmed *per curiam*, 188 F. 2d 574 (C. A. 4); *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243 (C. Cls.), certiorari denied, 346 U. S. 864; *S. S. Pierce Co.* v. *United States*, 127 F. Supp. 396 (D. Mass.), pending on appeal to the Court of Appeals for the First Circuit—argued June 7, 1955, but being held for decision by this Court herein; *Sharon Steel Corp.* v. *United States* (W. D. Pa.), decided March 22, 1955 (1955 P-H, par. 72,716), on appeal to the Court of Appeals for the Third Circuit—continued pending decision herein; *United States* v. *General Shoe Corp.*, 117 F. Supp. 668 (M. D. Tenn.), pending on

Perhaps typical of the cases holding the instruments involved not taxable is *Niles-Bement-Pond Co.* v. *Fitzpatrick*, 213 F. 2d 305, where the Court of Appeals for the Second Circuit distinguished its own prior decision in *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, certiorari denied, 332 U. S. 810. In the *Niles* case, the taxpayer gave 29 "Promissory Notes" totalling in excess of $3,000,000 to the National

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appeal to the Court of Appeals for the Sixth Circuit—argued April 27, 1955, but being held for decision by this Court herein; *Gamble-Skogmo, Inc.* v. *Kelm*, 112 F. Supp. 872 (D. Minn.); *General Motors Acceptance Corp.* v. *Higgins*, 120 F. Supp. 737 (S. D. N. Y.); *Knudsen Creamery Co. of California* v. *United States*, 121 F. Supp. 860 (S. D. Cal.); *Kobacker & Sons Co.* v. *United States*, 124 F. Supp. 211 (N. D. Ohio). Decisions holding the instruments involved not subject to the documentary stamp tax, in addition to the instant case, are: *Niles-Bement Pond Co.* v. *Fitzpatrick*, 213 F. 2d 305 (C. A. 2); *Curtis Publishing Co.* v. *Smith*, 220 F. 2d 748 (C. A. 3), petition for writ of certiorari filed July 22, 1955, No. 254, this Term; *Allen* v. *Atlanta Metallic Casket Co.*, 197 F. 2d 460 (C. A. 5); *Belden Mfg. Co.* v. *Jarecki*, 192 F. 2d 211 (C. A. 7); *United States* v. *Ely & Walker Dry Goods Co.*, 201 F. 2d 584 (C. A. 8); *Bijou Theatrical Enterprise Co.* v. *Menninger*, 127 F. Supp. 16 (E. D. Mich.), on appeal to the Court of Appeals for the Sixth Circuit—continued pending decision herein; *United Air Lines, Inc.* v. *United States* (N. D. Ill.), decided February 9, 1955 (1955 P-H, par. 72,567), on appeal to the Court of Appeals for the Seventh Circuit; *Motor Finance Corp.* v. *United States* (D. N. J.), decided July 2, 1954 (1954 P-H, par. 72,706); *Follansbee Steel Corp.* v. *United States* (W. D. Pa.), decided March 22, 1955 (1955 P-H, par. 72,715), on appeal to the Court of Appeals for the Third Circuit—continued pending decision herein; *Shamrock Oil & Gas Co.* v. *Campbell*, 107 F. Supp. 764 (N. D. Tex.).

City Bank of New York, each note being accompanied by a detailed loan agreement of the same form as the one involved in the instant case. The notes extended over a seven-year span, maturing periodically throughout that time. Judge Harlan, writing for the majority of the court, after pointing out that the repeal of the 1924 tax on promissory notes was not dispositive of the case, concluded that the instruments there involved were not "debentures." The decision was based largely on the fact that the *Niles* notes, unlike those in the *GMAC* case, were not marketable, there being no provision entitling the lender to request the borrower to break up the large notes into smaller ones. However, the court also emphasized such factors as language of "purchase," "sale" and "redemption" in the *GMAC* case and the fact that the lenders in the *GMAC* case were largely insurance companies who had bought the notes for investment purposes. All of these factors, the court noted, were absent in the *Niles* case.

For the reasons stated in Judge Clark's dissent in the *Niles* case, we do not think that such factors as the nature of the lender (i. e., whether bank or insurance company) or the words used in the agreement should determine whether a particular instrument is or is not subject to the stamp tax. As pointed out above, pp. 18–40, it seems to us that Congress undoubtedy wanted to tax all instruments protected by elaborate convenants and utilized for the purpose of large-scale, long-term

capital financing, without regard to the particular manner in which the particular instruments were sold. Therefore, with all due respect, we believe that in light of the complete interchangeability of the various forms of financing, the lines of distinction laid down in such cases as *Niles* result in an unwarranted discrimination which Congress could have not intended.

The important point for present purposes, however, is that, wholly apart from the validity of these distinctions, the *Niles* case and all other Court of Appeals cases decided against the Government on this issue are completely consistent with a decision for the Government in the instant case.[34] Indeed, the very factors stressed by

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[34] All of the Court of Appeals cases decided against the Government, save the *Allen* case (fn. 33, *supra*), also involved loans from banks with which the taxpayer had had prior dealings, and this fact was heavily relied upon by the respective courts. Conversely, no case involving a loan solely from an insurance company, save the *Allen* case and the instant case, has been decided against the Government. The *Allen* case was a somewhat unique case in that the loan there was relatively small and was secured by a realty deed, thus in effect constituting a mortgage. See *Commercial Credit Co.* v. *Hofferbert*, fn. 33, *supra*, p. 565.

While, for the reasons indicated, *supra*, pp. 42–43, we do not agree with the distinctions laid down in such cases as *Niles*, and consequently cannot accept the basic position taken by the taxpayer in its brief in opposition in *Smith* v. *Curtis Publishing Co.*, No. 254, this Term, it is interesting to note that that brief (p. 10) also recognizes that the present case is the only one in what it calls "The *GMAC* Group" which has been decided against the Government.

Judge Harlan in the *Niles* case to distinguish the *GMAC* case all militate towards taxability here. Thus in the present case the lenders were insurance companies, the loan was clearly for investment purposes (R. 98, 100), there was a specific provision entitling the lenders to request the borrower to break up the large notes into smaller notes and even to have a regular trust indenture set up (R. 88, 100-102),[35] language of purchase and sale was used (R. 94), and a premium was payable in case of premature redemption (R. 103-104). It is thus evident that on the very tests laid down in the *Niles* and other recent cases,[36] the instruments here involved are clearly taxable.

However, even though the result we urge is consistent with the cases holding against taxability of private placements, we urge that those cases are in error and that a sounder basis for upholding the tax here is, as we argue above, that Congress intended in Section 1801 to cover all long-

[35] See the reliance placed on this provision in *Commercial Credit Co.* v. *Hofferbert*, fn. 33, *supra*, p. 566, a case completely indistinguishable from the present case, as respondent acknowledged in its brief in opposition. (Br. 6.)

[36] For a recent District Court decision emphasizing the absence of some of these same factors as a basis for arriving at the conclusion that the instruments involved were not taxable, see *United Air Lines* v. *United States*, fn. 33, *supra*. And compare *Sharon Steel Corp.* v. *United States*, fn. 33, *supra*, with *Follansbee Steel Corp.* v. *United States*, fn. 33, *supra*, decided by the same court on the same day but reaching different conclusions.

term debt obligations supported by elaborate protective covenants and that this is so regardless of the details of the papers used, the language by which the transaction was consummated or the nature of the purchaser's business. In short we urge that the instruments should be taxed according to their fundamental nature.

CONCLUSION

For the reasons stated, the decision below should be reversed.

Respectfully submitted.

Simon E. Sobeloff,
Solicitor General.

H. Brian Holland,
Assistant Attorney General.

John F. Davis,
Assistant to the Solicitor General.

Ellis N. Slack,
A. F. Prescott,
Fred E. Youngman,
Attorneys.

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